Basel III Pillar 3 and Leverage Ratio disclosures of

ALTERNA BANK

December 31, 2023

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Overview

CS Alterna Bank, a member of the Canada Deposit Insurance Corporation ("CDIC"), operates under the name "Alterna Bank". It is a Schedule 1 Bank and received letter patents from the Minister of Finance of Canada to operate under the Bank Act on October 2, 2000. Alterna Bank is regulated by the Office of the Superintendent of Financial Institutions ("OSFI").

The registered office address of Alterna Bank is 319 McRae, Ottawa, Ontario, K1Z 0B9. The nature of Alterna Bank's operations and principal activities are the provision of deposit taking facilities and loan facilities to the clients of Alterna Bank across Canada. Basel III is the third in a series of international banking reforms known as the Basel Accords, aimed at improving the regulation, supervision, and risk management of the banking sector. It is composed of three pillars:

- Pillar 1: Addresses capital and liquidity adequacy and provides minimum requirements
- Pillar 2: Sets up supervisory monitoring and review standards
- Pillar 3: Prescribes public disclosures to promote market discipline

Effective April 1, 2023, CS Alterna Bank has adopted the Revised Basel III reforms in accordance with OSFI's new Small and Medium-Sized Deposit-Taking Institutions (SMSBs) Capital and Liquidity Requirements Guidline (SMSB Capital and Liquidity Guideline) and Pillar 3 Disclosures Requirements for SMSBs Guideline. CS Alterna Bank is categorized as Category II SMSB under SMSBs Capital and Liquidity Requirements Guideline. The disclosures produced within this document have been prepared in accordance with minimum disclosure requirements for Category II SMSBs listed in the Pillar 3 Disclosure Requirements for SMSBs Guideline (2024)[1]. Additional information can be found at OSFI's financial data website: Financial data for banks - Office of the Superintendent of Financial Institutions (osfi-bsif.gc.ca)

The information in this disclosures are unaudited and should be read in conjunction with 2023 financial statements. The Pillar 3 and Leverage Ratio Disclosures have been prepared in accordance with regulatory capital adequacy concepts and rules, rather than in accordance with International Financial Reporting Standards ("IFRS"). Therefore, some information in the Pillar 3 and Leverage Ratio Disclosures are not directly comparable with the financial information in the Alterna Bank's audited financial statements for 2023.

Capital Management

Alterna Bank's Capital Management Policy governs Alterna Bank's capital adequacy with respect to regulatory requirements and is consistent with Alterna Bank's risk appetite framework and strategic objectives. Alterna Bank's Internal Capital Adequacy Assessment Process (ICAAP) is integral to Alterna Bank's capital planning activities and assesses Alterna Bank's capital plan under stressed conditions to ensure appropriate capital adequacy of Alterna Bank. Regulatory capital requirements addressed by the policy include the leverage ratio and risk-based capital ratios (Common Equity Tier 1 ("CET1"), Tier 1 and Total Capital). The Capital Management Policy is reviewed annually by the Board.

OSFI's regulatory capital guidelines under Basel III reforms allow for two tiers of capital. Tier 1 capital includes CET1 capital comprised of common shares, reserves, retained earnings and accumulated other comprehensive income and Additional Tier 1 ("AT1") capital which includes qualifying additional tier 1 capital, non-cumulative perpetual preferred shares and regulatory adjustments. Tier 2 capital contains preferred shares, subordinated debt and regulatory adjustments. Alterna Bank's Tier 1 capital includes

[1] Pillar 3 Disclosure Guideline for Small and Medium-Sized Deposit-Taking Institutions (SMSBs) - Guideline (2024) - Office of the Superintendent of Financial Institutions (osfi-bsif.gc.ca)

common shares, retained earnings, and accumulated other comprehensive income. Tier 2 capital includes stage 1 and stage 2 loan allowances.

The risk-based regulatory capital ratios are calculated by dividing CET1, Tier 1 and Total capital by Risk-Weighted Assets ("RWA"). The calculation of RWA is determined by the OSFI-prescribed rules relating to on-balance sheet and off-balance sheet exposures and includes amounts for operational risk exposure calculated using the Simplified Standardized Approach (SSA). OSFI formally establishes risk-based capital minimums for deposit-taking institutions. These minimums are currently at CET1 capital ratio of 7.0%, Tier 1 capital ratio of 8.5% and a Total capital ratio of 10.5%.

The table below provides the key metrics for the quarter ended Q4 2023 and preceding four quarter-ends.

TABLE 1 - KM1: Key metrics (at consolidated group level)

		Q4 2023	Q3 2023	Q2 2023	Q1 2023	Q4 2022
	Available capital (amounts)					
1	Common Equity Tier 1 (CET1)	83,399	80,639	79,310	80,117	79,047
1a	Common Equity Tier 1 with transitional arrangements for ECL provisioning not applied	83,399	80,639	79,310	80,117	79,043
2	Tier 1	83,399	80,639	79,310	80,117	79,047
2a	Tier 1 with transitional arrangements for ECL provisioning not applied	83,399	80,639	79,310	80,117	79,043
3	Total capital	83,506	80,751	79,366	80,161	79,093
3a	Total capital with transitional arrangements for ECL provisioning not applied (%)	100%	100%	100%	100%	100%
	Risk-weighted assets (amounts)					
4	Total risk-weighted assets (RWA)	163,666	169,377	171,745	135,295	142,855
4a	Total risk-weighted assets (pre-floor)	163,666	169,377	171,745	135,295	142,855
	Risk-based capital ratios as a percentage of RWA					
5	CET1 ratio (%)	50.96%	47.61%	46.18%	59.22%	55.33%
5a	Common Equity Tier 1 ratio with transitional arrangements for ECL provisioning not applied	50.96%	47.61%	46.18%	59.22%	55.33%
5b	CET1 ratio (%) (pre-floor ratio)	50.96%	47.61%	46.18%	59.22%	55.33%
6	Tier 1 ratio (%)	50.96%	47.61%	46.18%	59.22%	55.33%
6a	Tier 1 ratio with transitional arrangements for ECL provisioning not applied (%)	50.96%	47.61%	46.18%	59.22%	55.33%
6b	Tier 1 ratio (%) (pre-floor ratio)	50.96%	47.61%	46.18%	59.22%	55.33%
7	Total capital ratio (%)	51.02%	47.68%	46.21%	59.25%	55.37%
7a	Total capital ratio with transitional arrangements for ECL provisioning not applied (%)	51.02%	47.68%	46.21%	59.25%	55.37%
7b	Total capital ratio (%) (pre-floor ratio)	51.02%	47.68%	46.21%	59.25%	55.37%
	Additional CET1 buffer requirements as a percentage of RWA					
8	Capital conservation buffer requirement (2.5% from 2019) (%)	2.50%	2.50%	2.50%	2.50%	2.50%
9	Countercyclical buffer requirement (%)	-	-	-	-	-
10	Bank G-SIB and/or D-SIB additional requirements (%) **[Not applicable for SMSBs]**					
11	Total of bank CET1 specific buffer requirements (%) (row 8 + row 9 + row 10)	2.50%	2.50%	2.50%	2.50%	2.50%
12	CET1 available after meeting the bank's minimum capital requirements (%)	46.46%	43.11%	41.68%	54.72%	50.83%
	Basel III Leverage ratio					
13	Total Basel III leverage ratio exposure measure	1,114,941	1,137,649	1,144,512	1,139,350	1,154,858
14	Basel III leverage ratio (row 2 / row 13)	7.48%	7.09%	6.93%	7.03%	6.84%
14a	Basel III leverage ratio (row 2a / row 13) with transitional arrangements for ECL provisioning not applied	7.48%	7.09%	6.93%	7.03%	6.84%

The modified minimum composition of capital disclosures are shown in the table below.

TABLE 2 - Modified CC1 : Composition of capital for SMSBs		
		2023
(000s)		**Amounts**
	Common Equity Tier 1 capital: instruments and reserves	
1	Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus	57,000
2	Retained earnings	31,100
3	Accumulated other comprehensive income (and other reserves)	(2,418)
4	*Directly issued capital subject to phase out from CET1 (only applicable to Federal Credit Unions)*	-
5	Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1)	-
6	**Common Equity Tier 1 capital before regulatory adjustments**	85,682
	Common Equity Tier 1 capital: regulatory adjustments	
28	**Total regulatory adjustments to Common Equity Tier 1**	(2,283)
29	**Common Equity Tier 1 capital (CET1)**	83,399
	Additional Tier 1 capital: instruments	
30	Directly issued qualifying Additional Tier 1 instruments plus related stock surplus	-
31	of which: classified as equity under applicable accounting standards	
32	of which: classified as liabilities under applicable accounting standards	
33	*Directly issued capital instruments subject to phase out from Additional Tier 1 (applicable only to Federal Credit Unions)*	
34	Additional Tier 1 instruments (and CET1 instruments not included in row 5) issued by subsidiaries and held by third parties (amount allowed in group AT1)	-
35	*of which: instruments issued by subsidiaries subject to phase out (applicable only to Federal Credit Unions)*	
36	**Additional Tier 1 capital before regulatory adjustments**	-
	Additional Tier 1 capital: regulatory adjustments	
43	**Total regulatory adjustments to additional Tier 1 capital**	-
44	**Additional Tier 1 capital (AT1)**	-
45	**Tier 1 capital (T1 = CET1 + AT1)**	83,399
	Tier 2 capital: instruments and provisions	
46	Directly issued qualifying Tier 2 instruments plus related stock surplus	
47	*Directly issued capital instruments subject to phase out from Tier 2 (applicable only to Federal Credit Unions)*	
48	Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties (amount allowed in group Tier 2)	
49	*of which: instruments issued by subsidiaries subject to phase out (applicable only to Federal Credit Unions)*	
50	Collective allowances	107
51	**Tier 2 capital before regulatory adjustments**	107
	Tier 2 capital: regulatory adjustments	
57	**Total regulatory adjustments to Tier 2 capital**	-
58	**Tier 2 capital (T2)**	107
59	**Total capital (TC = T1 + T2)**	83,506
60	**Total risk-weighted assets**	163,666
60a	**Credit Valuation Adjustment (CVA) Risk-weighted Assets (RWA)**	438
	Capital ratios	
61	Common Equity Tier 1 (as a percentage of risk-weighted assets)	50.96%
62	Tier 1 (as a percentage of risk-weighted assets)	50.96%
63	Total capital (as a percentage of risk-weighted assets)	51.02%
	OSFI target	
69	Common Equity Tier 1 target ratio	7.0%
70	Tier 1 capital target ratio	8.5%
71	Total capital target ratio	10.5%

The leverage ratio is defined as Tier 1 capital divided by the total exposure measure. Federally regulated deposit-taking institutions are expected to have Basel III leverage ratio that meet or exceed 3% at all times. The following table summarizes the Bank's Leverage Ratio for the quarter ended Q4 2023 and the preceding quarter-end.

TABLE 3 - LR2: Leverage ratio common disclosure

(000s)		Q4 2023	Q3 2023
On-balance sheet exposures			
1	On-balance sheet items (excluding derivatives, SFTs and grandfathered securitization exposures but including collateral)	1,105,891	1,125,088
2	Gross-up for derivatives collateral provided where deducted from balance sheet assets pursuant to the operative accounting framework (IFRS)		
3	(Deductions of receivable assets for cash variation margin provided in derivatives transactions)		
4	(Asset amounts deducted in determining Tier 1 capital)	(2,283)	(2,312)
5	**Total on-balance sheet exposures (excluding derivatives and SFTs) (sum of lines 1 to 4)**	1,103,608	1,122,776
Derivative exposures			
6	Replacement cost associated with all derivative transactions	7,232	8,649
7	Add-on amounts for potential future exposure associated with all derivative transactions	360	428
8	(Exempted central counterparty-leg of client cleared trade exposures)		
9	Adjusted effective notional amount of written credit derivatives		
10	(Adjusted effective notional offsets and add-on deductions for written credit derivatives)		
11	**Total derivative exposures (sum of lines 6 to 10)**	7,592	9,078
Securities financing transaction exposures			
12	Gross SFT assets recognised for accounting purposes (with no recognition of netting), after adjusting for sale accounting transactions	-	-
13	(Netted amounts of cash payables and cash receivables of gross SFT assets)	-	-
14	Counterparty credit risk (CCR) exposure for SFTs	-	-
15	Agent transaction exposures	-	-
16	**Total securities financing transaction exposures (sum of lines 12 to 15)**	-	-
Other off-balance sheet exposures			
17	Off-balance sheet exposure at gross notional amount	30,631	36,711
18	(Adjustments for conversion to credit equivalent amounts)	(26,890)	(30,916)
19	**Off-balance sheet items (sum of lines 17 and 18)**	3,741	5,795
Capital and total exposures			
20	**Tier 1 capital**	83,399	80,639
21	**Total Exposures (sum of lines 5, 11, 16 and 19)**	1,114,941	1,137,649
Leverage ratio			
22	**Basel III leverage ratio**	7.48%	7.09%

Risk Management

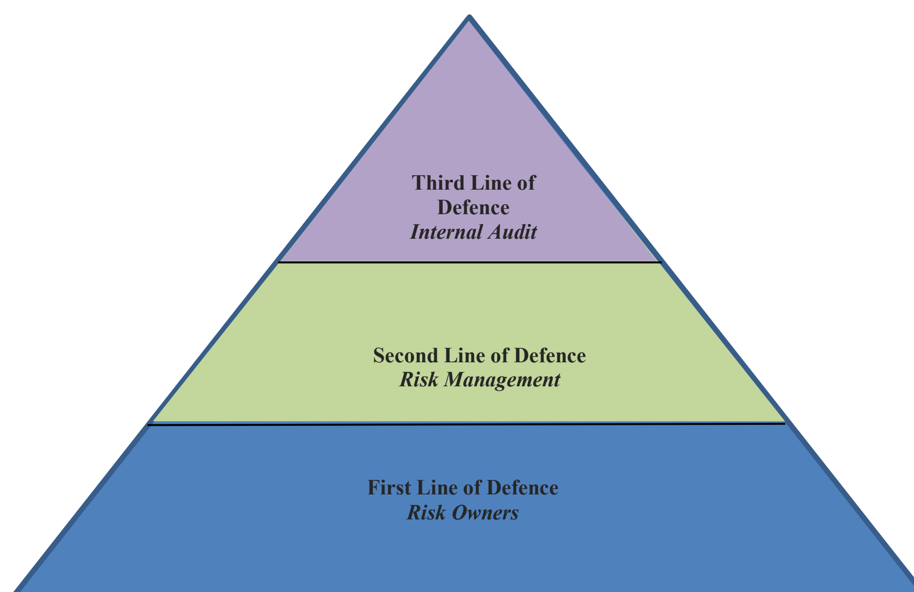
The Board of Directors approves the overall risk appetite and strategy of Alterna Bank and provides oversight to senior management. The Board reviews and approves risk management policies as appropriate and obtain assurances from senior management regarding compliance with these policies. Generally, the Board delegates to the Finance and Audit Committee (FAC) responsibility for governance related to Risk Management. One of the key roles of FAC is to review the risk appetite framework (a document that sets the risk appetite statement, risk limits and its governance), at least annually, and ensure that it is supported by the operational, financial and corporate policies, practices and procedures of Alterna Bank.

The Enterprise Risk Management Framework (ERMF) is the means by which the Board of Directors articulates their expectations for the mitigation and management of existing and potential risks. It also establishes the risk management expectations across the key risk areas and the aggregate risk. It sets out

Alterna's overall risk management approach, risk governance, and risk identification, assessment, mitigation, monitoring and reporting relative to the Board-approved Risk Appetite Framework (RAF). The ERMF also outlines how Alterna considers risk in its business and strategic planning.

Alterna Bank uses Three Lines of Defense model to provide for effective risk management and control objectives.

First Line of Defence ("1LOD"): Business units who are the risk and control owners, to identify and assess its operational risks and take appropriate corrective action;
Second Line of Defence ("2LOD"): Risk Management, to oversight and review of the risk profile and risk owners' mitigating actions.
Third Line of Defence ("3LOD"): Internal Audit, to provide independent and objective review regarding the effectiveness of appropriateness of Alterna Bank's operational risk management.



Alterna Bank is exposed to a number of risks as a result of holding financial instruments. The following is a description of major risks and how Alterna Bank manages the exposure to them.

a) Credit Risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. For Alterna Bank, the three main asset classes exposed to credit risk are loans, investments and derivative financial instruments on the balance sheets. Cash and cash equivalents on the balance sheets are placed with above grade rating financial institutions and therefore not exposed to significant credit risks.

Alterna Bank's credit risk objective is to minimize this financial loss. Credit risk is managed in accordance with the Credit Policy for loans and the Investment/Derivative Policy for investments and derivatives. These policies are reviewed and approved annually by the Board of Directors.

Loan exposures are managed and monitored through facility limits for individual and connected borrowers

and a credit review process. This review ensures that the borrower complies with internal policy and underwriting standards. Alterna Bank relies on collateral security typically in the form of a fixed and floating charge over the assets of its borrowers. Credit risk is also managed through regular analysis of the ability of clients to meet interest and principal repayment obligations and by changing these lending limits where appropriate.

Alterna Bank holds collateral against loans and advances to clients in the form of mortgage interests over property, other registered securities over assets, and guarantees.

Alterna Bank liquidates the collateral asset to recover all or part of the outstanding exposure in cases where the borrower is unable or unwilling to fulfil its primary obligations.

Credit risk is limited for mortgages secured by residential properties as 90% (2022 – 89%) of these mortgages are insured by mortgage insurance companies. Alterna Bank also monitors the concentration risk from commercial loans by setting maximum exposure limits for total loan balances for each industry. The carrying amount of financial assets recorded in the financial statements net of impairment losses, represents Alterna Bank's maximum exposure to credit risk without taking account of the value of any collateral obtained.

The lifetime expected credit losses ("ECL") on the credit-impaired loans as of December 31, 2023, were approximately $nil (2022 – $4,000) or 0.00% (2022 – 0.0004%) of total gross credit exposure at December 31, 2023. Therefore, no additional disclosures related to industry and geographic areas of these loans have been presented. For the accounting policy on the measurement of the ECL, refer to Note 2(e) of Alterna Bank's 2023 audited financial statements.

For qualitative disclosures with respect to definitions of past due and impaired loans, description of approaches followed for assessment of individual and collective allowances, and discussion of the credit risk management policy, refer to the following notes to Alterna Bank's 2023 audited financial statements:

Notes:	**Reference**
Impairment of financial assets	2(e)
Nature and extent of risks arising from financial instruments	4

(b) Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Alterna Bank's net income is exposed to interest rate risk because of the mismatches in maturities and interest rate types (fixed vs. variable) of its financial assets and financial liabilities.

Alterna Bank's interest rate risk management objective is to maximize interest margin while complying with the approved interest rate risk policy limits. Alterna Bank uses derivatives such as interest rate swaps to manage interest rate risk.

Interest rate risk is managed in accordance with the Structural Risk Management Policy. This policy is reviewed and approved annually by the Board. Alterna Bank reports the interest rate risk against policy limits to the Asset Liability Committee ("ALCO") on a monthly basis and the Board on a minimum quarterly basis.

Alterna Bank's maximum tolerable exposure to short-term interest rate risk over 12 months is restricted to

5% of forecasted net interest income with a 95% confidence level. Its maximum tolerable exposure to interest rate risk on the entire balance sheets is restricted to a 4.5% decline in the market value of equity to mitigate long-term interest rate risk.

(c) Liquidity Risk

Liquidity risk is the risk that Alterna Bank will encounter difficulty in meeting obligations associated with financial liabilities. Alterna Bank is exposed to liquidity risk due to the mismatch in financial asset and financial liability maturities and the uncertainty of daily cash inflows and outflows.

Liquidity risk is managed in accordance with the Liquidity Management and Funding Policy. The policy is reviewed and approved annually by the Board. Alterna Bank manages liquidity risk by monitoring cash flows and cash forecasts, maintaining a pool of high quality liquid financial assets, maintaining a stable base of core and term deposits, monitoring concentration limits on single sources of deposits, and diversifying funding sources. Alterna Bank reports the liquidity risk against policy limits to ALCO on a monthly basis and to the Board on a minimum quarterly basis.

(d) Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operation risk is therefore embedded in all day-to-day activities. It includes legal risk but excludes strategic or reputational risks. Operational risk is therefore embedded in all day-to-day activities, including the practices and controls used to manage other risks.

Operational Risk Management ("ORM") is an ongoing process applied across all our business activities, designed to identify potential operational risk events that may affect the organization and to contain these events to be within the operational risk appetite and risk tolerances in order to provide reasonable assurance regarding the achievement of Alterna Bank's objectives.

Alterna Bank has established policies that have been approved by the Board to manage and control operational risk. The Board policies govern the activities relating to oversight of business continuity, incident management and operational processes pertaining to third party, data, financial crime and fraud, on-going projects, technology, information and cyber security. Operations and the handling of day-to-day risks are the responsibility of management. In this regard, detailed operating procedures have been developed to successfully execute business strategies, operate efficiently and provide reliable, secure, and convenient access to financial services.

(e) Counterparty Credit Risk

All of Alterna Bank's derivative contracts are Over-the-Counter ("OTC") forward contracts that are privately negotiated between Alterna Bank and the counterparty to the contract.

For qualitative and quantitative disclosures relating to fair value methodology, hierarchical classification, credit risk mitigation and maturities of derivative portfolio, refer to the following notes to Alterna Bank's 2023 audited financial statements:

Notes:	Reference
Derivatives and Hedging	2(h)
Fair Value of Financial Instruments	17
Nature and Extent of Risks arising from Financial Instruments	4
Derivative Financial Instruments	18